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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Oil Companies Compensate for Dollar Devaluation: The Geneva Agreement

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1972

INTELLIGENCE MEMORANDUM

OIL COMPANIES COMPENSATE FOR DOLLAR DEVALUATION: THE GENEVA AGREEMENT

1. On 20 January 1972 the Persian Gulf members of the Organization of Petroleum Exporting Countries (OPEC) and the foreign oil companies operating in those countries (see the tabulation) agreed to a substantial increase in posted prices of petroleum. The increase is designed to restore to the oil producing countries the purchasing power lost because of the dollar's devaluation. The other OPEC members -- Algeria, Indonesia, Libya, Nigeria, and Venezuela -- had already increased their prices individually or are expected to do so in the near future. The agreement should add about $670 million in revenues to the Persian Gulf States in 1972, at least enough to compensate for the reduction in purchasing power of the dollar. It will not impose an added burden on the oil companies or cause much if any increase in retail prices in the major oil importing countries.

Parties to the 20 January 1972 Geneva Agreement

Companies	Persian Gulf Members of OPEC
British Petroleum	Abu Dhabi
Compagnie Francaise Des Petroles	Iran
Gulf Oil	Iraq
Mobil Oil	Kuwait
Shell Petroleum	Qatar
Standard Oil Company of California	Saudi Arabia
Standard Oil Company (New Jersey)	
Texaco	
Continental Oil	
Atlantic Richfield	
Standard Oil Company (Ohio)	
Hispanica De Petroleos S.A. (HISPANOIL)	
American Independent Oil Company of Iran	
Signal (Iran) Petroleum Company	

Note: This memorandum was prepared by the Office of Economic Research.

Background

2. The "posted price," the base price against which taxes and royalties to producing governments are assessed, is denominated in US dollars. Oil companies pay taxes and royalties either in US dollars or the dollar equivalent of other currencies. Under this system a devaluation of the dollar means that producing countries receive either the same quantity of depreciated US dollars or a lesser amount of the more valuable non-dollar currencies. Since oil revenues for the Persian Gulf States provide a dominant share of their foreign exchange earnings -- ranging from 75% in Iran to virtually 100% in Abu Dhabi -- the effect is to reduce substantially the oil countries' purchasing power in those countries whose currencies appreciate relative to the dollar.

3. The threat to the oil countries' purchasing power surfaced in May 1971 when the German mark was allowed to float upward, but did not become acute until 15 August 1971, when the United States suspended the convertibility of the dollar into gold and called for a realignment of international exchange rates. OPEC first reacted in September in a resolution calling for member states to join together to forestall a reduction in their purchasing power. The oil companies at first claimed that the devaluation was simply a reflection of inflation in the United States and that the Teheran agreement[1] of February 1971 already contained a provision for automatic annual posted price increases of 2.5% to adjust for inflation. This argument fell on deaf ears; and, in November, working level negotiations started between OPEC and the oil companies to determine the extent of OPEC members' losses. Uncertainty in the international monetary sphere, however delayed a settlement. Finally the new exchange rates agreed to by the "Group of Ten" on 18 December 1971 enabled the negotiators to estimate more precisely the degree to which the oil countries' purchasing power had been eroded. Meaningful negotiations began on 10 January 1972, and a final agreement was signed in Geneva on 20 January 1972.

The Agreement

4. The Geneva agreement increases the posted prices of Persian Gulf crude exports by 8.49%.[2] The posted prices of crude oil exported from Iraq and Saudi Arabia via pipeline to the eastern Mediterranean will be increased by the same percentage. This latter percentage can be changed,

25X1

2. This percentage increase was probably derived in order to yield the countries an increase in revenues closely conforming to the devaluation of the US dollar relative to gold.

however, if another Mediterranean producer, such as Libya, receives a higher price increase in subsequent negotiations. The new agreement is considered supplemental to the Teheran and related agreements hammered out in the first half of 1971 and will be effective from 20 January 1972 until the earlier agreements expire at the end of 1975.

5. In anticipation of future exchange rate changes, the accord also provides for further posted price adjustments based on a foreign exchange parity index of nine major currencies relative to the US dollar. These adjustments will be made quarterly beginning 1 April 1972.

Effect of the Agreement

Persian Gulf OPEC Members

6. In total, the Persian Gulf members of OPEC will receive increased oil revenues of about $670 million in 1972 as a result of the Geneva agreement (see Table 1). The Gulf States purchase about 60% of their imports from the major industrialized nations of Western Europe and Japan, which together have revalued by an average of 11% relative to the US dollar. The remainder of the Gulf States' trade is with the United States or with countries whose currencies have not changed or have changed little in relation to the dollar. Overall, therefore, it would seem that the Gulf countries will be more than adequately compensated for the reduced value of the dollar. Individual countries, however, will be affected differently, depending on their particular trade pattern. For instance, while 25% of total Gulf States' imports are purchased from West Germany and Japan -- the countries which have revalued the most -- the corresponding figure for Iran is 33% and for Iraq, 7%. Under present trade patterns, therefore, the benefit accruing to Iran will be substantially less than accrues to Iraq. This disparity can be reduced by shifts in future trade patterns, but trade relationships are slow in changing. Table 2 shows the Persian Gulf OPEC import pattern in 1970.

Other OPEC Members

7. Indonesia and Algeria individually control the actual sales prices of their crude oil exports on which their revenues are based. Venezuela has legislated the authority to set its own tax reference prices on oil exports. On 1 October 1971, Indonesia raised its prices by 17% to offset the "de facto" devaluation of the US dollar -- particularly the substantial devaluation in relation to the Japanese yen. Indonesia sells most of its oil exports to Japan and buys a substantial part of its imports there. Although the 17% increase closely conformed to the eventual increase in the value of the yen relative to the dollar, Indonesia raised its prices by an additional 14% in early February 1972. A substantial part of these increases probably

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Table 1

Persian Gulf Members of OPEC: Estimated Increase in Government Revenue in 1972 Resulting from the 20 January Settlement

	Abu Dhabi	Iran	Iraq	Kuwait a/	Qatar	Saudi Arabia a/	Total
	US $ per Barrel						
Pre-settlement							
Average posted price b/	2.336	2.260	2.670	2.180	2.387	2.280	2.30
Government revenue	1.30	1.20	1.56	1.27	1.30	1.32	1.30
Post-settlement							
Average posted price b/	2.534	2.452	2.897	2.365	2.590	2.474	2.50
Government revenue	1.42	1.31	1.68	1.37	1.40	1.43	1.41
Increase							
Average posted price b/	0.198	0.192	0.227	0.185	0.203	0.194	0.20
Government revenue	0.12	0.11	0.12	0.10	0.10	0.11	0.11
	Million Barrels						
Estimated exports in 1972 c/	350	1,700	650	1,250	150	2,000	6,100
	Million US $						
Government revenue d/							
Pre-settlement	455	2,040	1,014	1,588	195	2,640	7,932
Post-settlement	497	2,227	1,092	1,713	210	2,860	8,599
Increase	42	187	78	125	15	220	667

a. Including one-half of the Neutral Zone.
b. Average weighted by production of crude oils of different quality.
c. Based on oil company estimates for individual countries.
d. Calculations are based on full year 1972, although agreement was not effective until 20 January 1972.

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Table 2

Persian Gulf Members of OPEC: Import Pattern with Selected Countries a/
1970

Value in Million US $

	Destination													
	Iran		Iraq		Kuwait		Qatar		Saudi Arabia		Abu Dhabi b/		Total	
Origin	Value	Percent of Total	Value	Percent of Total	Value	Percent of Total	Value	Percent of Total	Value	Percent of Total	Value	Percent of Total	Value	Percent of Total
United States	219	13.2	18	3.5	69	11.0	Negl.	Negl.	155	17.6	Negl.	Negl.	461	11.9
Japan	197	11.9	16	3.1	104	16.6	0	0	99	11.2	41	29.9	457	11.8
Belgium	49	3.0	26	5.1	8	1.3	2	3.6	23	2.6	0	0	108	2.8
France	74	4.5	30	5.9	51	8.2	3	5.4	37	4.2	0	0	195	5.0
Italy	91	5.5	15	3.0	28	4.5	2	3.6	38	4.3	0	0	174	4.5
Netherlands	45	2.7	11	2.2	0	0	2	3.6	24	2.7	0	0	82	2.1
Sweden	25	1.5	21	4.1	4	0.6	Negl.	Negl.	10	1.1	Negl.	Negl.	60	1.6
Switzerland	52	3.1	8	1.6	10	1.6	0	0	14	1.6	0	0	84	2.2
United Kingdom	175	10.6	61	12.0	96	15.4	20	35.7	93	10.5	65	47.4	510	13.2
West Germany	354	21.4	18	3.5	46	7.4	4	7.1	71	8.0	0	0	493	12.7
Other	377	22.6	284	56.0	209	33.4	23	41.0	319	36.2	31	22.7	1,243	32.2
Total	*1,658*	*100.0*	*508*	*100.0*	*625*	*100.0*	*56*	*100.0*	*683*	*100.0*	*137*	*100.0*	*3,867*	*100.0*

a. Because of rounding, components may not add to the totals shown.
b. Data for the Trucial States. Abu Dhabi is the only Trucial State member of OPEC, but separate data are not available.

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was related to factors other than the yen's appreciation, for example, the low sulfur content of Indonesian crude oil. The Venezuelan government traditionally sets a new tax reference price for oil exports every year. The last annual change was made on 21 December 1971, when the price was increased 32 cents a barrel – about 12% -- for oil exported during calendar year 1972, of which 6 cents was tied to the dollar's devaluation. Since this change was made after the international monetary realignments had been agreed to, it is unlikely that Venezuela will increase its prices further as a result of the Geneva agreement. Algeria's national oil company, SONATRACH, produces almost 80% of the country's oil and had already concluded contracts for the sale of all of its 1972 production before the 20th of January. Some of SONATRACH's sales contracts contain an escalation clause tying price to the dollar's value; and the company apparently is invoking this clause, possibly in response to the Geneva agreement.

8. Libya and Nigeria both plan to open negotiations with oil companies and probably will achieve settlements comparable to the 8.49% increase obtained by the Persian Gulf countries. Such an increase in posted price would yield Libya about $150 million and Nigeria about $100 million of additional revenue in 1972.

Oil Companies

9. The Geneva settlement will not impose an added burden on most international oil companies. Approximately 70% of the Gulf countries' oil exports are sold in Western Europe and Japan, where local currencies have appreciated by an average of 11% relative to the US dollar. A substantial share – probably at least 80% -- of the crude oil sales from the Persian Gulf move through thoroughly integrated company channels. The marketing subsidiaries of the international oil companies receive appreciated currencies at the consuming end while producing subsidiaries make payment in devalued US dollars at the extraction end. From at least 15 August 1971 to the new agreement of 20 January 1972 the vertically integrated international oil companies had been enjoying a profit "windfall," since domestic oil prices in Western Europe and Japan had been generally stable. The oil producing countries, on the other hand, were sustaining losses -- in the form of reduced purchasing power. The new agreement simply helps to restore the two parties approximately to their original positions. For the smaller oil producing companies lacking marketing subsidiaries in Japan and Western Europe the effect of the Geneva agreement will depend on the terms of the contracts concluded with the importers. If the sales price has been denominated in US dollars, the windfall has been enjoyed by the importer and the Geneva agreement will impose an added burden on the oil company. If the sales contract provides for payment in an appreciated currency or contains an escalation clause based on exchange rates, the

non-integrated producer, like the integrated company, will simply be moved closer to its original position.

Oil Consumers

10. The Geneva agreement should have little effect on retail prices in the major oil importing countries. There is no justification for increasing retail prices in Japan and Western Europe, because the oil companies are already receiving additional income from the appreciation of these countries' currencies, and the increased dollar payments to the oil producing countries apparently do not exceed the increased dollar value of oil sales. Even if the oil companies successfully pass on the extra dollar costs by increasing retail prices, the result would be an increase of less than 4%[3] in the price of crude oil imported by Western Europe and Japan and an increase of less than one-quarter of 1% in the costs of total imports. Such a change is easily overshadowed by even minor changes in tanker rates. The increased government revenue per barrel wrought by the Geneva agreement amounts to 11 cents, or only about one-quarter of a cent per gallon. By comparison, the retail price of regular gasoline in the United Kingdom is 70 cents per US gallon.

11. On the other hand, the price of Persian Gulf crude oil exported to the United States and to less developed countries whose currencies were devalued or were not substantially appreciated almost certainly will increase. The United States, however, imports petroleum mainly from Venezuela and Canada, and the increased dollar payments to the Persian Gulf countries should have little effect on imported petroleum costs to the United States. If the whole increase were passed on in the form of higher prices, the increased costs to the United States would amount to only $20 million in 1972. At the same time the United States stands to gain through increased exports to the Persian Gulf States. For many less developed countries, however, the burden could be substantial. India, for example, faces higher oil import costs of about $10 million in 1972, further aggravating its annual trade deficit.

3. The percentage increase in cost at the importing end is less than half the percentage increase in oil countries' revenues because transportation and production costs make up at least half the delivered price of petroleum.